

# *Rethinking Engagement on the Korean Peninsula: Confidence to Trust to Peace*

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## **Abstract**

In the aftermath of the sinking of the South Korean naval vessel *Cheonan*, inter-Korean relations are at possibly the lowest point in decades. With rising tensions, increasing propaganda and threatening military posturing on both sides of the border, the prospect of peace on the Korean peninsula in the near future is dim. In particular, the cessation of most inter-Korean economic cooperation threatens stability, and could have long-term implications. Now is the time for South Korea, the United States, and other concerned parties to re-evaluate the objectives and means of their policies toward North Korea. Abandonment of North Korean nuclear weapons and weapons programs is an important but long-term goal. Now, it is necessary to economically engage North Korea in order to lay the groundwork for confidence-building, trust-building, and ultimately, a peace regime that will contribute to unification efforts. By encouraging private-sector, market-driven foreign investment into joint ventures and infrastructure projects, we can engage, rebuild, and educate North Korea. By avoiding government assistance programs, we can avoid politization of the projects, and let market economics encourage North Korea to move toward becoming a reasonable, stable and transparent member of the international community.

**Key Words:** Foreign Direct Investment, engagement, inter-Korean relations, DPRK economy, peace regime

## New Engagement

At the beginning of 2010, a flurry of diplomatic efforts, both by Pyongyang and other Six-Party participants, increased hopes that dialog on the North's nuclear disarmament would once again get underway. However, the *Cheonan* incident, the closing of the Mount Keumgang tourism facilities, and increased rhetoric and accusatory mudslinging on both sides of the DMZ have jolted us back to the reality that is the distrusting inter-Korean relationship. Now, with a multi-national investigative team finding evidence strongly linking North Korea to the sinking of the ROK warship, tensions have flared, inter-Korean cooperation has slowed to a trickle, and responsive and retaliatory measures are likely to further heighten tensions. While no one was anticipating the near-term abandonment of what is practically the only bargaining chip Pyongyang is holding as it seeks to engage the United States in peace treaty negotiations, the current chill in economic assistance to the North from both South Korea and other regional players does not bode well for anyone hoping for denuclearization and peaceful relations.<sup>1</sup> The current atmosphere discourages North Korean engagement and transparency and further encourages the state to rely on brinkmanship tactics of coercion.

On the other hand, Kim Jong-il claims to still be committed to denuclearization, and Pyongyang has taken a number of steps that suggest it is actively seeking foreign investment and international economic cooperation, indicating a willingness to comply with international

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<sup>1</sup> "Seoul Mulls Halting All Trade with N. Korea," *Chosun Ilbo*, May 18, 2010; "South Korea Freezes Funds for North Korea after Warship Sinking," *AFP*, May 17, 2010; Jang Sejeong, "Wen Jiabao 'Kim Jong-il Pagyek-Jiwon Yocheong' Keobu [Wen Jiabao Rejects Kim Jong-il[s] Exceptional Aid Request]," *JoongAng Ilbo*, May 17, 2010.

standards. If we are to reverse the deterioration of peace and stability on the peninsula and gain from North Korea's desire for foreign capital,<sup>2</sup> we need a new approach to Pyongyang. The last two decades of dealings with North Korea gives little hope that Kim Jong-il will abandon his nuclear arsenal soon. Neither sanctions nor appeasement, negotiations nor abandonment have pressured or prompted Pyongyang into denuclearization, the main obstacle to improved inter-Korean relations. Pressure from neighboring countries concerned about instability, and from the international community wary of U.S. unilateralism, means American military options are practically (although not officially) off the table, and even as South Koreans are convinced of the North's complicity in the sinking of an ROK warship, the threat of escalation prevents Seoul from taking any retaliatory military actions. Economic sanctions pressure Kim Jong-il less than the domestic economic crises through which he has survived, and without full Chinese cooperation, are a relatively weak tool; and religious and humanitarian groups have yet to succeed in moving past basic humanitarian aid and building a real network of development assistance projects. Beijing will not risk Korean peninsular instability by isolating North Korea and pressuring Kim Jong-il to denuclearize. Beijing has concluded that it must choose between stability and denuclearization, and it has chosen stability.<sup>3</sup> The United States and South Korea have, therefore, chosen principled sanctions and patient disengagement.

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<sup>2</sup>- North Korea has repeatedly changed its position on dialogue, but went further than normal on April 14, 2009, when its foreign ministry declared that "the six-party talks have lost the meaning of their existence," and that "the DPRK will never participate in such six-party talks." "DPRK foreign ministry vehemently refutes UNSC's 'Presidential Statement,'" *KCNA*, April 14, 2009.

<sup>3</sup>- Similar comments were made by several Chinese participants in the (Track II) US-China Strategic Dialogue held in Honolulu, HI May 3-4.

Arguments could be made for either – for really turning the screws, and for turning our backs – but no good comes out of just tepidly walking the line between them. Twice already we have mistakenly taken an interested-but-wait-and-see approach, and all it got us was today’s opportunity to do it again.

North Korea is in clear violation of international protocols and deserves to be sanctioned; Pyongyang demands it be treated with respect, but respect is earned, and sanctions should not be dropped until North Korea acts in a responsible manner in accordance with the obligations it has sworn to take on as a member of the United Nations and other international organizations. As U.S. Assistant Secretary of State Philip Crowley stated, the sinking of the *Cheonan* “was a clear and compelling violation of the existing armistice. It was without doubt a hostile act. It was provocative. It was unwarranted...[and] there will clearly be consequences to North Korea.”<sup>4</sup> For peace to have any chance on the Korean peninsula, North Korea must understand the need to conduct business in a responsible and productive manner. However, the impact of principled sanctions in the past has been questionable. So, too, has South Korean, Japanese and American unilateral and/or allied retaliation for the North’s indiscretions, as Chinese investment has and likely will continue to quickly fill the void left by sanctions, limiting the long-term economic impact on the North. On the other hand, an influx of private-sector foreign capital through cooperative investment ventures might prove much more influential. It would be better for both North and South Korea if investment into the North was more diversified. One thing both Koreas

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<sup>4</sup>– From the transcript of Assistant Secretary Crowley’s May 21, 2010 Daily Press Briefing, accessed at <http://www.state.gov/t/pa/prs/dpb/2010/05/142093.htm>.

have in common is a fear that Chinese economic leverage over North Korea could grow too large.

North Korea is, by and large, a rational actor. In fact, “not only are Kim Jong-il and other North Korean decision makers acting rationally, they are also acting relatively successfully, considering their priorities, having managed to maintain power for over a decade...all the while extracting food, cash, fuels, and other forms of aid without being forced to make significantly compromising concessions.”<sup>5</sup> Ralph Cossa has long asserted that Kim Jong-il will hold onto his nuclear deterrent and continue his belligerence as long as he believes “that the benefits to be gained outweigh current (or anticipated) consequences.”<sup>6</sup> While Cossa sees the lack of “serious and sustained consequences” as the motivation for Kim maintaining a program, and possibly risking proliferation, the lack of a palpable opportunity cost for noncompliance and uncooperative behavior has also discouraged North Korea from dropping its bellicose attitude. Here, we are in a bit of a Catch-22. In attempts to punish the North’s actions and squeeze the regime, we opt for sanctions, attempting to limit the capital available to Pyongyang. However, the economic imbalance on the peninsula makes it very difficult for North Korea to see itself as an equal, and as long as it is reliant on international aid, real negotiations with South Korea are difficult at best. Without sufficient capital, North Korea cannot rebuild its economy to the point of being

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<sup>5</sup>-Kevin Shepard, *North Korea’s Foreign Policy and Bounded Rationality: Post-Cold War Policy Regarding the United States*, Ph.D. Dissertation (Seoul: The Graduate School of North Korean Studies, Kyungnam University, 2009), p. 230.

<sup>6</sup>-Quote taken from Ralph A. Cossa, *North Korea: Assessing Blame: Examining Motives*, Pacific Forum CSIS, PacNet Number 52, October 20, 2006. Cossa has reiterated the same argument in discussions with the author on numerous occasions, the latest being March 11, 2010.

confident enough to enter into trust- and peace-building measures with Seoul. As Pyongyang seeks the necessary foreign capital to fund its economic and infrastructure reform efforts, it has had no qualms about turning to weapons proliferation and other illegal efforts, incurring further ire from the international community, resulting in even fewer legitimate avenues for the North to take to bring in the money it needs.<sup>7</sup>

What we need to do in order to break this cycle is to encourage an atmosphere in which North Korea can entice foreign investment that can help restore its infrastructure without resorting to proliferation or illegal activities. In the words of Charles Kartman, “economic engagement could change North Korea’s perception of its own self-interest,” leading Pyongyang to reverse hostile and isolationist policies and engaging more responsibly with its neighbors.<sup>8</sup> While only by re-engaging North Korea can we progress toward the establishment of a ‘peace regime,’ on the other hand, Pyongyang’s propensity for politicizing engagement is discouraging. The April 2010 seizure of South Korean government and private-sector investments in the Keumgang tourist resort was an unfortunate move by Pyongyang. Designed to pressure Seoul to restart tours, this short-sighted move not only heightens the Lee Myung-bak administration’s distrust, it has the potential to scare off potential investors from any country. The most recent example of North Korea politicizing investment came when it threatened that, should South Korea retaliate for the sinking of the

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<sup>7</sup>- Many reports have detailed North Korea’s illegal activities, with perhaps the most comprehensive being Sheena E. Chestnut’s “The “Sopranos State”? North Korean Involvement in Criminal Activity and Implications for International Security,” her MPhil thesis for Stanford University published May 20, 2005.

<sup>8</sup>- Charles Kartman and Susan Shirk, “North Korea Inside Out: The Case for Economic Engagement,” Asia Society Center on U.S.-China Relations, December 2009.

*Cheonan*, Pyongyang “will strongly react to them with such merciless punishment as the total freeze of the inter-Korean relations, the complete abrogation of the North-South Agreement on Non-aggression and a total halt to the inter-Korean cooperation undertakings.”<sup>9</sup> The solution is to lessen the political risk of investment in North Korea by avoiding government subsidies and allowing market functions to drive foreign investor interests. When North Korea creates an environment attractive to foreign investors and begins to draw in the capital needed to repair its infrastructure and build up its economy, real discussions on lasting peace can begin.

While the United States continues to pursue the elimination of North Korean nuclear weapons, President Barack Obama has prioritized the prevention of nuclear proliferation on the global scale, and North Korea is but one part of a larger puzzle for Washington. This has caused some in Seoul to worry that U.S.-DPRK bilateral negotiations could lead to Washington accepting a nuclear North Korea. While U.S. officials have stated repeatedly that Washington will not recognize North Korea as a nuclear power, the reality is that Pyongyang already possesses nuclear technology and nuclear weapons. What must be done now is to work on elimination of the weapons and weaponization programs while ensuring, in the mean time, that technology, know-how, and fissile materials stay within North Korean borders. An important element of this effort, along with Proliferation Security Initiative actions, port security strengthening and international cooperative surveillance and enforcement, is to remove the incentive; North Korea’s primary motivation for developing a nuclear

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<sup>9</sup>- “DPRK accuses South Korea of linking ship sinking with the North,” *KCNA*, May 21, 2010. Accessed at [www.kcna.co.jp](http://www.kcna.co.jp) on May 21, 2010.

weapons program may have been a deterrent, for prestige and recognition, or some combination of both, but proliferation efforts would likely be driven by little more than cold, hard cash. By encouraging private sector, market-driven foreign investment, we can encourage responsible behavior while at the same time providing a means for Pyongyang to earn foreign capital without resorting to activities threatening to the security of the peninsula, region, and world at-large.

### **Seeking the Peace We Seek**

The first step in drafting a new policy toward North Korea is clearly identifying the objectives of such a policy. All regional actors have vocally and repeatedly lent their support to peace efforts by both North and South Korea, and the governments in both Seoul and Pyongyang regularly call for the establishment of a 'peace regime,' yet no concrete steps toward a more peaceful relationship have been agreed upon. Among the myriad reasons we are no closer today to the establishment of such a 'regime' as we were years ago when the term gained traction in inter-Korean politics is the fact that there has been little discussion about what, exactly, this 'peace regime' ultimately looks like. Without having a common understanding of the peace which is sought, it is impossible for the two Koreas, as well as other concerned and invested governments, to discuss action plans and benchmarks.



### ***Defining the Issue for South Korea***

South Korean President Lee Myung-bak's foreign policy and national security vision boasts "strengthening a denuclearized peace structure" as a key agenda item for inter-Korean relations.<sup>10</sup> However, the administration's priorities are murky. Seoul identifies the North Korean nuclear issue as the most fundamental military threat and obstacle to peace and unification. It then goes on to speak of North Korea's nuclear weapons development. The North Korean nuclear weapons program is problematic, for the Korean peninsula, region and internationally. The North Korean "nuclear issue" is not necessarily so. The international community has already resigned itself to allowing a peaceful nuclear program in North Korea, and has even cooperated on providing such a program. Lee Myung-bak's policy toward the North calls for the dismantlement of North Korean nuclear weapons prior to receiving economic assistance and improved relations with Seoul and Washington, and notes, "so long as North Korea refuses to withdraw its nuclear menace, genuine trust and cooperation between the two Koreas will remain elusive."<sup>11</sup> Yet, as long as North Korea comes to terms of the IAEA and all applicable international agreements, the existence of a peaceful nuclear energy and/or research facility will likely exist. Even the latest U.S. Nuclear Posture Review frees North Korea of the threat of a U.S. nuclear attack as long as it becomes a responsible member of the IAEA, and this would not require the abandonment of its entire nuclear program. Lee Myung-bak is determined to convince the North to denuclearize through "creative pragmatism," but

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<sup>10</sup>- *Global Korea: The National Security Strategy of the Republic of Korea* (Seoul: Cheong Wa Dae, Office of the President, June 2009), p. 11.

<sup>11</sup>- *Ibid.*, p. 16.

also insists that “the only way to ensure its own survival...is to completely abandon its nuclear weapons in an internationally verifiable manner.”<sup>12</sup> This is a necessary, but long-term, goal of negotiations with the North. It will also likely be very costly. In previous negotiations, South Korea went to great lengths to ensure that it would remain influential in the worldview of North Korea, and opened itself up to considerable financial burdens in order to control KEDO actions following the 1994 Agreed Framework, scraping, borrowing and begging to finance over 80% of the project, thus bearing most of the financial burden of the project’s failure.<sup>13</sup> The Lee administration is determined not to let that happen again. That said, North Korea recently promised to have a light-water reactor before 2020.<sup>14</sup> This was our answer in 1994; it should not be seen as a problem now.

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<sup>12</sup>- *Global Korea*, p. 15.

<sup>13</sup>- A South Korean official was quoted as saying, “The [South Korean] government will exert every possible effort to have a South Korean company picked as KEDO’s prime contract... South Korea has endeavored to take the largest possible share of the orders [for the KEDO construction project] in a bid to expand exchanges with North Korea,” and, “According to estimates by economic ministries here, South Korea can independently take charge of a maximum of 82.1 percent of the whole project.” Key-young Son, “South Korean Firm Should Be Named KEDO’s Prime Contractor for NK Reactor Plan,” *The Korea Times*, October 29, 1994.

<sup>14</sup>- In April, 2009, North Korea announced that it would actively develop a light water reactor. Now, it has announced, “The DPRK will witness the appearance of a light water reactor power plant relying on its own nuclear fuel in the near future in the 2010s.” KCNA on Despicable Inside Story about Megaphone War, KCNA, March 29, 2010. It is noteworthy that the KCNA did not indicate the LWR would be of North Korean design (despite the reporting by Western media). Accessed at <http://www.kcna.co.jp/item/2010/201003/news29/20100329-15ee.html> on April 2, 2010.

### ***Peace through the Eyes of the North***

The North Korean perspective on trust, disarmament and reunification is quite different from that of the South. Pyongyang accuses the United States and South Korea of failing to honor previous agreements on denuclearization, and is untrusting of agreements due to subsequent administrations in both Washington and Seoul choosing not to recognize previous administrations' commitments to Pyongyang. Specifically, the North asserts that "it is the Bush administration which is chiefly to blame for having reduced the [Agreed Framework] to a dead document" due to its "unilateral decision, a wanton violation of the agreement between the governments and a perfidy to its dialogue partner," to delay then eventually shut down the Korean Peninsula Energy Development Organization, which was responsible for the construction of two light-water nuclear reactors in the North.<sup>15</sup> In the Lee Myung-bak administration, Pyongyang sees a "group of traitors" that has "refused to implement the historic June 15 Joint Declaration and the October 4 Declaration, totally negating them."<sup>16</sup> It also sees the cessation of unconditional aid and government-sanctioned and supported cooperation as a reversal of the policies of the previous administrations.

While North Korean propaganda is obviously antagonistic and exaggerated, it does reflect genuine concerns of North Korean policymakers. Positioning the regime to engage the international community, Kim

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<sup>15</sup>-KCNA, "KCNA Urges U.S. to Compensate for Losses Caused by Scrapping AF," December 19, 2005. Accessed at <http://www.kcna.co.jp/item/2005/200512/news12/20.htm#9> on March 9, 2010.

<sup>16</sup>-KCNA, "Ten Major Crimes of Lee Myung-bak Group Disclosed," February 26, 2009. Accessed at <http://www.kcna.co.jp/item/2009/200902/news26/20090226-11ee.html> on March 9, 2010.

Jong-il and other elite in Pyongyang are well aware of the fate of other communist leaders who had let Western ideology seep in, causing transition of the society and economy snowball out of central control. The 1989 executions of Romanian dictator Nicolae Ceausescu and his wife Elena were well known in Pyongyang, and Kim Jong-il is determined to maintain control of the military and to rally the people of North Korea around him. His choice of tools: Nationalism and fear mongering. It is said that North Korean elite were ordered to watch videos of the execution of Ceausescu and his wife to ensure that they were all aware of what was at stake if the North Korean regime were to fall.<sup>17</sup> And of course, just in case that failed, Kim Il Sung and Kim Jong-il massively increased the number of bodyguards protecting the family. Former bodyguard to both Kim Il Sung and Kim Jong-il, North Korean defector Myong-chol Kim recalls, "When I entered [the North Korean bodyguard service] there were only about 3,000 to 4,000 bodyguards, but after the killing of Ceausescu and his wife in Romania in 1989, they increased the number and now it's about 70,000."<sup>18</sup> Pyongyang is also acutely aware of the subjugation of East Germans as second-class citizens following reunification,<sup>19</sup> as well as the inflationary troubles faced by Moscow and other former Soviet satellite states upon attempts to open and privatize their economies. This makes Pyongyang wary of South Korean investment and cooperation offers, as it lacks confidence in its own ability to manage its economy

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<sup>17</sup>- Michael Sheridan, "China may back coup against Kim," *The Australian*, October 16, 2006.

<sup>18</sup>- Bradley Martin, *Under the Loving Care of the Fatherly Leader* (New York: St. Martin Press, 2004) p. 547.

<sup>19</sup>- According to a survey by the research firm Emnid, 74% of former East Germans "felt like second-class citizens since Germany reunited." "Communism Seems Preferable to Some Germans After 17 Years," *Deutsche Welle*, March 10, 2007. Accessed at <http://www.dw-world.de/dw/article/0,2144,2806093,00.html> on April 13, 2010.

and prevent unification through absorption.

With the current lack of trust and understanding between the two Koreas and the United States, Pyongyang will not abandon its nuclear weapons merely on the promise of future rewards. On the other hand, it is not feasible for Washington or Seoul to reward North Korea for merely returning to points in negotiations from which it has previously retreated, effectively rewarding them repeatedly for making the same concession. On the North's strategy of brinkmanship negotiation, President Obama stated, "We are not intending to continue a policy of rewarding provocation," and one of his chief strategists said of the North's Yongbyon nuclear facility, "Clinton bought it once, Bush bought it again, and we're not going to buy it a third time."<sup>20</sup>

### **Building a Foundation of Trust**

North Korea proposes "to put an end to the vicious cycle of distrust and build confidence with a view to pushing ahead with denuclearization," and proposes a peace treaty between Pyongyang and Washington, through which "confidence will be built between the DPRK and the U.S. to put an end to the hostile relations and give a strong impetus to the denuclearization of the peninsula."<sup>21</sup>

The peace and unification strategies of the two Koreas are, however, far from in synch. North Korea calls for the creation of a Korean

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<sup>20</sup>-David E. Sanger, "U.S. Weighs Intercepting North Korean Shipments," *New York Times*, June 7, 2009.

<sup>21</sup>-KCNA, "US Urged to Make Decision to Conclude Peace Treaty," January 29, 2010. Accessed at <http://www.kcna.co.jp/item/2010/201001/news29/20100129-07ee.html> on March 9, 2010.

Federation, urging, “There is no reason for the North and the South of Korea to fight against each other as they are one nation. They should choose the reunification based on federation which would make it possible to reunify the country in a peaceful way.”<sup>22</sup> The North Korean proposal of “one nation and state and two systems and governments” that “neither ensures the dominance and interests of either the North or the South nor does harm to any side”<sup>23</sup> would allow economic integration while protecting the North’s regime. The South Korean unification policy, however, takes for granted the dominance of the South Korean system, and is committed to “unification based on free democracy;”<sup>24</sup> and one of the publicly announced goals of the Ministry of Unification for 2010 is “comprehensive research on 20 years of German unification,”<sup>25</sup> or, ‘how to absorb the failed state next door.’

### ***Finding Common Ground***

Obviously, trust is necessary for peace, peace is necessary for reconciliation, and reconciliation must precede unification, but what peace? What style of unification? How can trust be built? South Korea is calling for peace with the North, while the North is calling for peace with Washington. On the other hand, President Barack Obama, speaking about peace, defended war, arguing that countries will at times “find the use of force not only necessary but morally justified,” and defended armed

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<sup>22</sup>-KCNA, “Reunification by Federal Formula Called For,” February 24, 2010.

<sup>23</sup>-Ibid.

<sup>24</sup>-*Global Korea*, p. 15.

<sup>25</sup>-Ministry of Unification webpage. Accessed at <http://www.unikorea.go.kr/eng/default.jsp?pgname=POLworkplan> on March 9, 2010.

conflict on the Korean peninsula, stating that “the blood of our citizens and the strength of our arms” have prevented a third World War, and that “the service and sacrifice of our men and women in uniform has promoted peace and prosperity from Germany to Korea.” Doing so, he argued, was in “our enlightened self-interest.”<sup>26</sup>

Seoul, Pyongyang and Washington are all on very different pages when it comes to defining a “peace regime” on the Korean peninsula. However, President Obama made two other points in his speech that are particularly relevant to the pursuit of peace on the Korean peninsula. First, that in order to successfully create a peace regime, we need to focus “on a more practical, more attainable peace, based not on a sudden revolution in human nature but on a gradual evolution in human institutions.” This can be seen in the policies Washington has adopted regarding the North Korean nuclear issue.

Second, that “it is undoubtedly true that development rarely takes root without security; it is also true that security does not exist where human beings do not have access to enough food, or clean water, or the medicine they need to survive. It does not exist where children do not aspire to a decent education or a job that supports a family.”<sup>27</sup> In other words, it does not exist in North Korea. This challenges South Korean President Lee Myung-bak’s strategy of offering development assistance to North Korea only after Pyongyang abandons its nuclear ambitions. This is because among the many roles North Korea’s nuclear program plays

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<sup>26</sup> - The full text of President Obama’s remarks at the Nobel prize acceptance ceremony was accessed at <http://www.whitehouse.gov/the-press-office/remarks-president-acceptance-nobel-peace-prize> on March 3, 2010.

<sup>27</sup> - *Ibid.*

in DPRK strategy, it ensures that the international community will continue to show interest in North Korean issues, and it gives Pyongyang the leverage to negotiate assistance for rebuilding its dilapidated energy and transportation infrastructures; an essential step in economic recovery. By helping North Korea develop its infrastructure and economy, Washington, Seoul and Pyongyang can find common ground in pursuing peace on the peninsula.

### ***Building Confidence in North Korea***

The promise of future economic returns for the immediate abandonment of its nuclear “deterrent” is not sufficient to bring Pyongyang around. The regime lacks confidence and decision-makers are inundated with propaganda on the dangers of engagement. The Kim Jong-il regime will advance slowly and carefully as domestic confidence builds, and this, in turn, will encourage trust only after economic returns begin to come in. North Korea has no significant network of powerful allies, nor does it any longer have a benefactor, as it did during the Cold War. Despite economic and moral support from China, when fending against a stronger state such as South Korea or the U.S., the weaker North Korea has chosen to rely on internal balancing (not unlike its Cold War-era strategy employed against its benefactors).<sup>28</sup>

In the post-Cold War era, Kim Jong-il has consistently reached out to Western governments in order to create diplomatic relations and boost

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<sup>28</sup> - While North Korea relied on security guarantees from China and the Soviet Union to ensure its survival as it faced off with South Korea and the United States, Pyongyang constantly maneuvered between Beijing and Moscow to ensure that its two protectors were vying for its loyalty, not the other way around.



the economy, while at the same time pursuing his ‘Military-first Politics’ as state-run media laments the threat of attack by American forces stationed in South Korea.<sup>29</sup> At the beginning of the post-Cold War era, Pyongyang stressed the need “to develop its economic relations with foreign countries,”<sup>30</sup> but with the caveat, “while adhering to the principles of independence, complete equality and mutual benefits in foreign economic relations.”<sup>31</sup> This theme - and especially the emphasis on equality and independence - continues today. At the end of the Cold War, Kim Il Sung warned that “the danger of war is always seriously hanging in the air,” and as a new level of development was underway in Asia, the imperialist threat lay in the true intentions of what Washington called its “peaceful actions.” He also warned that South Korea was looking to “adopt other countries’ tactic of unification-by-absorption” and stressed the need to continue with the socialist struggle.<sup>32</sup> North Korean propaganda does not read significantly different today, in the aftermath of the *Cheonan* incident.

On the other hand, a growing number (and variety) of foreign investors have placed their bets in North Korea, working directly with DPRK counterparts. While these projects have reported their share of

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<sup>29</sup> - While the term, ‘Military-first Politics’ did not appear in North Korean media prior to 1997. Editorial, *Rodong Sinmun*, December 12, 1997. And the government mouthpiece claims it was launched on January 1, 1995, when Kim Jong-il “declared military-first politics on this land as if he fired a cannon.” Paek Ryong, “The General and Soldiers Are in Complete Harmony,” *Rodong Sinmun*, November 18, 2001. This more accurately marked the culmination of Kim Jong-il’s efforts to consolidate the military, rather than the launch of a new policy. In fact, the 1992 DPRK Constitution details the establishment of the “military-first political system.”

<sup>30</sup> - Song Jun So, “DPRK’s Foreign Economic Relations Expand Continuously,” *Foreign Trade of the Democratic People’s Republic of Korea* (No. 9(312) 1990), pp. 2-3.

<sup>31</sup> - *Ibid.*

<sup>32</sup> - “Sinnyeonsa [New Year’s Address],” *Rodong Sinmun*, January 1, 1992.

problems in dealing with the North, they have consistently reported improved access, growing economic savvy, improved productivity, and other factors indicating that lessons, directly and indirectly, about economic and other aspects of the outside world are being absorbed by the North Korean workforce and authorities.<sup>33</sup>

North Korea has not only been vocal about its desire to engage the international community, it has invested significantly in preparing for increased foreign trade and investment, and passed considerable amounts of legislation to support furthering economic ties with the international community. In the last decade, the North has legitimized markets, passed laws on the protection of commercial activity and private property, strengthened individual responsibility and decentralized production-related decision-making, made some moves, although much more is necessary, toward enhancing the role of law and broadening the role of the judicial system, and with the help of South Korean legal experts, drafted a number of laws protecting investments and otherwise creating a more attractive investment atmosphere for foreign entrepreneurs.<sup>34</sup>

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<sup>33</sup>- According to the co-founder and director of the Pyongyang Business School, "North Korean staff can easily be trained and reach international standard...all North Koreans, stemming from many different organizations that worked with me were all hard working and eager to learn." From Felix Abt, "North Korea - doing business in a demanding environment," *Insight Asia-Pacific*, German Asian-Pacific Business Association, Hamburg, September 2009, p. 28. GPI Consultancy, working with the Netherlands Council for Trade Promotion and the DPRK Chamber of Commerce, has arranged annual business missions to the North, labeling them "very successful...with tailor-made business meetings and company visits, interesting and well-varied [opportunities]." Geir Helgeses and Nis Hoyrup Christensen, "North Korea 2007: Assisting Development and Change," Nordic Institute of Asian Studies, 2007.

<sup>34</sup>- For more details, see Dae-Kyu Yoon, "Economic Reform and Institutional Transformation: A Legal Perspective," in Phillip H. Park (ed.), *The Dynamics of Change in North Korea: An Institutional Perspective* (Seoul: The Institute for Far Eastern Studies, Kyungnam University, 2009), pp. 43-74.

## North Korean Efforts

Despite Pyongyang's often heard and longstanding propaganda regarding its 'self-reliance,' North Korea has not only always been open to foreign capital; the country's very existence has been dependent upon it. During the height of the Cold War, Kim Il Sung stated, "The support and aid...of the Soviet Union, the People's Republic of China, the German Democratic Republic, Romania, Mongolia, Bulgaria, Albania, Vietnam, Hungary, Czechoslovakia and Poland have played a big part in accelerating our socialist construction,"<sup>35</sup> and even as he strove to build the self-determination of North Korea, he acknowledged, "needless to say, we fully recognize the importance of international support and encouragement and consider foreign aid a necessity."<sup>36</sup> Kim also advocated pragmatism, posing the question, "It does not matter whether you use a spoon or chopsticks, your right hand or left hand when at the table. No matter how you eat, it is all the same insofar as food is put into your mouth, isn't it?"<sup>37</sup>

Following the end of the Cold War and the loss of its main benefactor, North Korea was also left without many of its Eastern European trading partners, and China's shift away from 'friendship pricing' and free-flowing assistance meant that Pyongyang needed a new diplomatic

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<sup>35</sup>- Kim Il Sung, "Joseonrodangdang Je4-cha Daehwiesoe Han Pehwisa [Report to the Fourth Congress of the Workers' Party of Korea] (1961)," *Kim Il Sung Seonjib* [Kim Il Sung Works], No. 27 (Pyongyang: Workers' Party of Korea Publishing House, 1999), p. 467.

<sup>36</sup>- Kim, "On Socialist Construction in the Democratic People's Republic of Korea and the South Korean Revolution (1965)," p. 171.

<sup>37</sup>- Kim Il Sung, "On Eliminating Dogmatism and Formalism and Establishing *Juche* in Ideological Work" (December 28, 1955), a speech rejecting Khrushchev's de-Stalinization campaign. Accessed online at [www.korea-dpr.com/cgi-bin/simpleforum.cgi?fid=04&topic\\_id=1135935712](http://www.korea-dpr.com/cgi-bin/simpleforum.cgi?fid=04&topic_id=1135935712) on September 20, 2008.

and economic strategy. It chose to reach out to the international community and global market, but to do so requires capital, and this is something the North sorely lacks. In its first few adventures in economic cooperative projects, special economic zones were the preferred choice, as they allowed authorities to isolate foreign influences and cut off the flow of outside information. On December 28, 1991, North Korea designated the Rajin-Sonbong region a 'special economic zone,' and promoted the area as part of the United Nations Development Program's Tumen River Area Development Program.<sup>38</sup> North Korea's Vice Chairman of the Commission of External Economic Affairs, Jong Mo Kang, bragged that the Rajin-Sonbong would "be of great significance in the development of our foreign economic relations."<sup>39</sup> While this free trade zone ultimately failed due to North Korean authorities' overzealous oversight and inability to refrain from administrative meddling, many lessons were learned; North Korea based future, and more ambitious, foreign investment opportunities on this experience. Efforts are now underway to revive the plan, having established 'Rason Special City.'

Just before the death of Kim Il Sung in 1992, the North enacted constitutional revisions to support its bid for foreign investment. One article was added, reading, "The State shall encourage institutions, enterprises or associations of the DPRK to establish and operate equity

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<sup>38</sup>-The North's Administration Council Decision No. 74 stated, "Free economic and trade zones shall be created in Rajin and Sonbong, North Hamgyong Province. Rajin, Sonbong, and Chongin Port shall be free trade ports, and foreigners are allowed to establish and run various forms of business including co-production, joint venture and foreign-funded business and engage in service business of various forms." "DPRK Administration Council on Creating Free Economic and Trade Zones," *Foreign Trade of the Democratic People's Republic of Korea* (No. 2(329) 1992), p. 12.

<sup>39</sup>-"Foreign Trade Developing in the DPRK," p. 13.

and contractual joint venture enterprises with corporations or individuals of foreign countries,” and another new article stated, “The DPRK shall guarantee the legal rights and interest of foreigners in its region.” On October 5, 1992, the (North) Korean Supreme People’s Assembly promulgated the Foreign Investment Law, the Contractual Joint Venture Law, and the Foreigners’ Enterprise Law, to be followed on January 31, 1993 by the Law on Foreign Investment Enterprises and Taxation on Foreigners, the Foreign Exchange Administration Law, and the Law on Free Economic and Trade Zones. These laws were in addition to the existing Equity Joint Venture Law (September 8, 1984), which was followed up by the Regulations Concerning the Operation of Joint Ventures and the Law on Foreigners’ Income Tax (March 7, 1985). Many had high expectations for economic growth and international engagement when the North began passing such laws, but a lack of confidence and incredible political investment risk meant that these early efforts to attract foreign capital failed. However, many of these efforts have continued, as is noted below, and North Korea continues to attempt to create an environment attractive to foreign investors.

For example, North Korea has operated the International Korean Business Centre for nearly two decades; a center which it describes as a “comprehensive one-stop service for worldwide companies and individuals interested to trade and explore opportunities with the DPR of Korea,” with offices in Pyongyang, Thailand and Spain.<sup>40</sup> The business centre

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<sup>40</sup> – “Official Webpage of The Democratic People’s Republic of Korea.” The website is run by The Korean Friendship Association, which is led by Special Delegate of the Committee for Cultural Relations with Foreign Countries. Andro Cao de Benos is also president of the International Korean Business Centre, <http://www.korea-dpr.com/business.htm>.

is proud to have reached deals with “first-class companies in Italy, Switzerland, Netherlands, Thailand, Australia, Arab Emirates and other countries in the fields of shipbuilding, garment manufacturing, IT programming, film animation, mining, food stuff production, electronics, arts & crafts, etc.”<sup>41</sup> The centre also hosts several business delegations for potential investors each year, and claims that since it started these visits in 2007, approximately 80 percent of delegation members ended up signing contracts with the North Korean government.<sup>42</sup>

Despite the North’s ambitions, there are concerns that the North’s infrastructure simply cannot support modern industrial production. Dilapidated power grids, antiquated equipment and the lack of material resources in the North cause many factories to grind to a standstill, while others are unable to provide a full day’s work to employees.<sup>43</sup> As the North’s economy slowly imploded in the 1990s, operations at manufacturing plants throughout the country had fallen off by as much as 75 percent,<sup>44</sup> and have yet to completely rebound in the 21<sup>st</sup> century. However, North Korean authorities try to find the silver lining, advertising to potential foreign investors the availability of “highly qualified, loyal and motivated personnel” that the government promises “will not abandon their positions for higher salaries once they are trained” without noting

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<sup>41</sup>- International Korean Business Centre itinerary for a foreign business delegation hosted in February 2010, <http://www.korea-dpr.com/kfa2010/kfa-biz-feb-2010.htm>.

<sup>42</sup>- Ibid.

<sup>43</sup>- Cho Jeong-ah, et al., *Bukhan Juminui Ilsangsaenghwal* [The Everyday Lives of North Koreans] (Seoul: Tongilyeonguwon [Korea Institute for National Unification]), December 31, 2008, pp. 35-36.

<sup>44</sup>- Hyeong-jung Park, *Bukhan-ui Kyeongje Kwanli Chegye: gigu-wa unyeong* [Economic Management System of North Korea: Organization and Operation] (Seoul: Haenam Publishing House, 2002), p. 29.

that this is largely because they would have nowhere else to go.<sup>45</sup> Many observers are also appalled by the actions of the North's People's Security Bureau and other means used by the Kim's regime to maintain control of every aspect of the lives of the people, but the regime is proud to advertise that "all business [is] made directly with the government...a government with solid security and [a] very stable political system," and guaranteeing "exclusive distribution of products (sole-distribution)."<sup>46</sup>

Another website, "Naenara," is maintained by the Korea Computer Center. This site prominently displays the North's laws on foreign investment, equity joint ventures and contractual joint ventures. It also lists the North's foreign trade corporations and agencies, and it provides this information for potential foreign investors in Korean, English, French, Spanish, German, Russian, Chinese, Japanese, and Arabic.<sup>47</sup> North Korea also publishes a quarterly English-language journal, *Foreign Trade*, advertising products for export, but also highlighting successful foreign investments and advertising potential opportunities for others interested in helping Pyongyang get its hands on foreign capital. The latest issue (No. 414, 2010) advertises, "There are many profitable investment projects in the DPRK including sectors of metal, power, coal and rail transport, service sectors like communications, air transport and hotels, and IT and other hi-tech domains," and does so in an article on ORA Bank, a joint venture bank set up in 2007 by the North's Foreign Trade Bank and Egypt's ORAKAP Far East Holding.<sup>48</sup> Relations with these two entities

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<sup>45</sup> - "Official Webpage of The Democratic People's Republic of Korea."

<sup>46</sup> - Ibid.

<sup>47</sup> - <http://www.kcckp.net/en/>

<sup>48</sup> - "ORA Bank," *Foreign Trade*, No. 414, 2010. Accessed at [http://www.kcckp.net/en/periodic/f\\_trade/index.php?contents+1446+2010-01+43+10](http://www.kcckp.net/en/periodic/f_trade/index.php?contents+1446+2010-01+43+10) on February 17, 2010.

have diversified into hotel renovation, cellular phone networking, cement production, and more. The North's ventures into these cooperative projects mean opportunities for engagement with the outside world, and opportunities to learn from and influence North Korean officials and residents.

These steps, while far from comprehensively or sufficiently enforced, were designed to prepare the North Korean economy for foreign investment and to give it some semblance of attractiveness to foreign investors. North Korea has continued to improve conditions for, and now relies quite heavily on, foreign investment. This also indicates that the technocrats in Pyongyang have been acquiring more of a voice. This is exactly the direction in which Washington, Seoul and the rest of the concerned international community should encourage the North to move.

### **No Time Like the Present**

The January 1, 2010 New Year's Joint Resolution stated, "It is the consistent stand of the DPRK to establish a lasting peace system on the Korean peninsula and make it nuclear-free through dialogue and negotiations." It also called for the improvement of the daily lives of North Koreans through reform of the agricultural and light industry sectors. To this end, the North needs to rebuild its basic social infrastructure, including electrical, transport, and communications networks. The establishment of the Taepung International Investment Group, the revitalization of the Rajin-Sonbong free trade area, large-scale, long-term investment projects with both China and Russia in mining and transportation, and repeated announcements by the North's government-owned media



outlets reveals the North's ambition to make the necessary improvements by raising foreign capital and enticing overseas investments. If Pyongyang is determined, we have one of three choices: provide assistance, encourage investment, or deal with the North's illegal economic activities.

Kim Jong-il has set his own deadline for creating his legacy. He declared that in 2012, he would "open the gate to a great prosperous and powerful nation." The development of nuclear weapons allows him now to focus on the 'prosperity' half of that goal, and the last year has seen the 150-day battle and 100-day battle, grand attempts at currency reform and market restructuring, an emphasis on the development of light industry and agriculture, and a full-court press to attract foreign investment. The extent to which North Korean authorities attempted to overhaul the economy, cut down inflation and reign in independent wealth with overarching currency reforms at the end of 2009 and beginning of 2010 reveal an urgency felt for economic success. The failure of these reforms reflects the lack of sophistication in North Korean tactics, and highlights an area in which re-engagement, through private-sector, pragmatic exchanges and investments, and through NGO and government-supported training opportunities, could allow for at least some influence on the perceptions of policy makers.<sup>49</sup> The extent to which North Korea is actually ready to allow such cooperation is, however, questionable. Furthermore, Pyongyang's insistence on playing politics with inter-Korean cooperative

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<sup>49</sup>- Training programs on capitalism and market economics have been held previously for officials from the Ministry of Foreign Affairs, Ministry of Trade, the Economy Inspection Division of the Korean Workers' Party, National Planning Committee, the Department of National Security Defense, the University of the People's Economy and Kim Il Sung University. Jong Dae Shin and Dean J. Ouellette, "Human Resource Development and International Cooperation," *The Dynamics of Change in North Korea* (Seoul: Kyungnam University, 2009), p. 268.

economic projects is likely to discourage foreign investors. Seizing South Korean assets in Keumgang and abandoning contracts regarding Kaesong illustrate the short-sightedness of North Korean decision-making; while some Chinese tour companies appear ready to take advantage of the Keumgang facilities, they are not likely to pay as much for the tours as Hyundai-Asan, and Pyongyang's actions regarding the Kaesong Industrial Complex could discourage others from front-loaded investments.

Currently, targeted sanctions are in response to Pyongyang's refusal to play by international rules, and should not be lifted for any reason other than North Korean compliance. However, the sanctions are limited in scope, and the limited impact of those sanctions is further weakened by Chinese trade. Dick Nanto and Mark Manyin postulate that "it is possible that China views sanctions on exports of luxury goods as "unenforceable," since such goods can be bought on the open market by North Korean traders," and note that UN sanctions have had "little effect on China's exports of luxury goods," as such the amount of such exports has actually continued to rise since China approved the UN censure of the North's nuclear and missile testing.<sup>50</sup> While the potential impact of sanctions has been the loss of access for the North to as much as two billion USD in overseas lending,<sup>51</sup> sources inside the North say that businesses are operating the same as ever (not that they operated particularly well before)<sup>52</sup> while PRC-DPRK trade continues to grow, despite the sanctions,

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<sup>50</sup>- Dick Nanto and Mark Manyin, "China-North Korea Relations," *CRS Report for Congress*, March 9, 2010. Accessed at [www.nautilus.org/for\\_a/security/10016CRS.pdf](http://www.nautilus.org/for_a/security/10016CRS.pdf) on March 9, 2010.

<sup>51</sup>- Mary Beth Nikitin, et. al., "North Korea's Second Nuclear Test: Implications of U.N. Security Council Resolution 1874," *CRS Report for Congress*, July 23, 2009, p. 12. Accessed at <http://www.fas.org/sgp/crs/nuke/R40684.pdf> on March 16, 2010.

<sup>52</sup>- "Buk Oueguk tujaga-deul: saeobche eoryeoum eobta [North foreign investors: no

to an average of 100-200 million USD per month, and approximately 10 percent of which is made up of sanctioned luxury goods.<sup>53</sup> In addition, the U.S. decision to not only back off pressures applied to the Banco Delta Asia, but to jump through hoops to return frozen funds to the North in a manner dictated by Pyongyang, showed the North that we were not ready to play chicken with them. In the aftermath of the Cheonan incident, Seoul banned only some inter-Korean economic cooperation (allowing companies in the KIC to continue manufacturing), and what losses the North will suffer will likely be lessened by increased Chinese investment. If we won't take a hardline approach, then we should take advantage of the increased access to the average North Korean to change their image of the 'imperialist American aggressor' and support a growing middle-class of consumers and government of technocrats that understand the benefits of opening up and engaging the international community. This is how we can encourage North Korea to take a more responsible and open approach to inter-Korean and international affairs. This is the first step in building a 'peace regime' on the Korean peninsula.

### **Setting the Ball in Motion**

Without resolution of the *Cheonan* incident, it appears difficult to return to nuclear and peace negotiations. We need to re-evaluate the goals of our North Korea policies, and the best strategies and tools available to reach them. Experts agree that Pyongyang is a relatively rational actor, and when offered an option better than the status quo, North Korea can be

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difficulties with the business framework],” *No Cut News*, March 10, 2010.

<sup>53</sup>-Nanto, “China-North Korea Relations.”

enticed out of its shell. This is because Pyongyang relies heavily on its internal-balancing approach to relations with both South Korea and the United States, yet is well aware of its relative weakness on most fronts. Without economic and infrastructure repairs, North Korea will continue to lack the confidence necessary to take meaningful trust-building steps, and without trust, there is no hope of a peace regime on the Korean peninsula, and little chance of a denuclearized North Korea.

While denuclearization under the Kim Jong-il regime is unlikely, those states concerned with a peaceful and stable Korean peninsula can and should encourage confidence-building measures through investment, particularly in projects that, while economically viable and relatively secure for the investor, also help to restore North Korean infrastructure. Kim Jong-il can't live forever, and now is the time to 'get in on the ground floor,' building relationships, confidence and opportunities for furthering trust and peace in the future.

### ***Objectives***

By economically engaging North Korea, we can:

- Establish outposts of cooperation, creating opportunities for dialogue and a window through which North Koreans can more clearly hear the voice of the international community; messages delivered through invested, private-sector partners of the North Koreans can more easily overcome Pyongyang's attempt to outside information as being sinister propaganda or political maneuvering.
- Educate North Koreans, from technocrats and factory managers to

farmers and market traders, in the ways of market economics and trade. This can help stabilize both the North's economy and foreign policy by deterring short-sighted or narrowly-focused decisions; increasing consistency builds confidence and improves foreign and inter-Korean relations as well as improves standards of living. This would again encourage Pyongyang to be more accepting of trust-building cooperative efforts by offering economic and diplomatic incentives for responsible and transparent behavior.

- Rebuild infrastructure and improve power and transportation woes, thereby improving the lives of the people. In the short-term, this could possibly embolden the North to be more selective in its cooperative ventures and more apt to try to regain central control of the economy, but as was seen in early 2010, improving the economic situations of the North Korean people by supporting market economics actually serves to restrict central government control over the economy and encourage capitalistic tendencies among market-goers. Increasing public wealth will increase the expectations of the people on their government, while at the same time, the central government's relative decline in control over the economy means the people are less reliant on the regime for food and other necessities, further eroding the basis of the Kim Jong-il regime's hold over the people.
- Inevitable regime change (Kim Jong-il cannot live forever) will provide a window of opportunity for a shift in the direction of the regime's politics, both domestically and internationally. Now is the time to lay the seeds of encouragement and introduce the incentives of becoming a more responsible and transparent actor. Prior to significant shift in

Pyongyang politics, interested governments should encourage economic engagement but avoid politicizing investments or investing public funds to the point of becoming vulnerable to Pyongyang's strategy of threatening private-sector investment in order to build support for appeasement policies within the domestic public of the target country, a tried-and-true tactic in its negotiations with Seoul.

### ***Action Plans***

In order to most pragmatically engage North Korea in way that would reach the objectives listed above, Washington, Seoul, and the international community would be well served to:

- Encourage pragmatic, private-sector economic and financial cooperation; avoid government subsidies or insurance that would dull the incentive for North Korea to provide a transparent and friendly investment atmosphere, but limit sanctions and other barriers to cooperation. Prevention of proliferation is an obvious task-at-hand, as is limiting the North's access to technology that could be used to further its weapons programs. However, private-sector investment in joint ventures and other cooperative projects.
- Support efforts for educational and training opportunities, including technical and other support, in-country training, courses offered outside the North, and even texts, syllabi and online and/or digital courses on topics such as international banking, global economics, market economics, corporate governance, and more.

- Encourage ROK-PRC-Russia-DPRK working-level talks on cross-border rail, road, and energy grid, connections, and promote cooperation such as recent Russian and Chinese investment in port, rail and road revitalization projects within the North in conjunction with economically viable and strategic projects, including port access and energy exploration.

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